SEC Enforcement

SEC Use of Extraterritorial Authority Dependent on Circumstances, Official Says

By Yin Wilczek

Whether the Securities and Exchange Commission decides to pursue extraterritorial fraud under authority restored by Congress in the wake of *Morrison v. National Australia Bank Ltd.* will depend, as in any enforcement action, on the facts and circumstances, a senior official said May 15.

Elizabeth Jacobs, deputy director of the SEC's Office of International Affairs, noted that information gathering remains a major challenge for the commission in cases involving transactions or parties located outside the United States.

However, she added, the commission has been getting more help from its foreign counterparts through agreements such as the International Organization of Securities Commissions' multinational memorandum of understanding.

Jacobs spoke at a panel organized by the D.C. Bar. She said she voiced her own views, which did not necessarily reflect those of the commission or other staff members.

In other comments, panelists also suggested that Congress, despite heavy lobbying by institutional investors and the plaintiffs' bar, is unlikely to act this year to repeal *Morrison* or otherwise to restore investors' private right of action against cross-border fraud. Accordingly, they said, it will be up to the courts further to develop--and perhaps relax--the contours of the U.S. Supreme Court's ruling.

Transactional Test.

In the landmark *Morrison* decision, the high court majority applied a longstanding principle under U.S. law that congressional legislation, unless otherwise stated, is intended to apply only within the territorial United States. Based on that tenet, the court concluded that Section 10(b)--the 1934 Securities Exchange Act's antifraud provision--applies only to transactions in securities listed on U.S. exchanges, or to securities transactions that take place in the United States (121 SLD, 6/25/10).

Congress responded to the decision by attempting to restore the SEC and Department of Justice's extraterritorial reach through Section 929P of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. The provision states that federal courts

have jurisdiction over enforcement actions involving conduct in the United States that "constitutes significant steps in furtherance of the violation," or conduct occurring abroad that has a "foreseeable substantial effect within the United States."

The SEC since has maintained that Dodd-Frank effectively restored the so-called "conduct and effects" test for commission enforcement actions. Some commentators, however, have questioned the efficacy of the legislative fix, arguing that Section 929P addressed subject matter jurisdiction, whereas *Morrison* involved the scope of Section 10(b). The SEC's stance has not been ruled upon by a court.

Challenge Unlikely.

Speaking to BNA after the panel, J. Campbell Barker, an associate at Yetter Coleman LLP, Austin, Texas, said it is unlikely that the SEC will be challenged on its extraterritorial authority. Section 929P was a clear response by Congress to the Supreme Court's analysis in *Morrison*. It would be difficult for a court to hold otherwise, in effect rendering the provision superfluous, he said.

During the panel, Daniel Sommers, a partner at Cohen Milstein Sellers & Toll PLLC, Washington, said the fallout from *Morrison* has gone beyond so-called "foreign cubed" cases--involving foreign plaintiffs suing foreign issuers in a U.S. court for foreign transactions--to impact "F1" and "F2" cases.

Although U.S. institutional investors arguably could convert their foreign holdings to American Depositary Receipts--which most courts applying *Morrison* have treated as domestic transactions--institutional investors have been reluctant to do so because of certain "limitations," including transactional costs, Sommers said. In any case, investors "shouldn't be making investment decisions based on the fallout from *Morrison*," he said.

ADRs are securities issued by U.S. banks and traded on U.S. exchanges that represent shares of foreign issuers that the banks hold in trust.

Giovanni Prezioso, a partner at Cleary Gottlieb Steen & Hamilton LLP, Washington, countered that U.S. investors who choose to invest in foreign instruments are not without a remedy. In addition to the SEC's extraterritorial enforcement reach, there also has been an "evolution" of class action-type remedies in other jurisdictions such as the Netherlands and Italy, suggested Prezioso, who was general counsel at the SEC from 2002 to 2006.

'Cold Comfort.'

However, Sommers responded that foreign jurisdictions have only just begun to provide remedies for securities fraud. He said it will take another 10 to 20 years before such remedies become meaningful for U.S. investors.

The reality is that today, there are no foreign remedies akin to the U.S. class action, Sommers said. Even though the Netherlands has been touted as a possible venue for class actions, the Dutch statute only provides a settlement remedy to which both sides must agree.

In the meantime, the SEC is facing resource constraints even as its responsibilities expand under Dodd-Frank, Sommers continued. “To say institutional investors can go overseas to seek relief or rely on the SEC is cold comfort, at least for now,” he said.

What could be beneficial is for Congress to craft legislation that would create a bright-line test that makes it easier for parties to predict whether their cases are actionable, suggested Christian Ward, an Austin-based partner at Yetter Coleman. *Morrison*'s transactional test, though described by some as a bright-line rule, “gets fuzzy” when applied in certain circumstances, he said.

Ward cited, for example, the U.S. Court of Appeals for the Second Circuit's recent decision in *Absolute Activist Value Master Fund Ltd. v. Ficeto* (42 SLD, 3/5/12). The ruling suggests that the appellate court is looking to “push the boundaries” of *Morrison*, Ward said.

Barker agreed that Morrison's transactional test could get “increasingly fuzzy,” especially now that parties are attempting to apply it outside the '34 Act context to statutes such as the 1933 Securities Act. “It would be nice to see Congress clarify the issue,” he said.

Congress Will Not Act.

However, Prezioso and Ward concurred that congressional action to restore the conduct and effects test for private actions is unlikely this year, especially given the upcoming elections. Instead, judicial decisions is “what we're watching,” Prezioso said.

In other comments, Jacobs said the SEC's recent study on what steps Congress could take with respect to private rights of action for transnational fraud (71 SLD, 4/13/12) was “unusual” in the extent to which foreign governments weighed in. One major concern for the foreign governments was whether their policy choices regarding

remedies for securities fraud would be usurped by the United States. Their comments helped the staff to “crystallize” the issue of “comity,” she said.

Looking ahead, an interesting issue will be how comity evolves, Jacobs continued. IOSCO has done a lot of work to make securities standards in different jurisdictions comparable, so there is now less opportunity for conflict, she said. Class actions in the United States for many decades has been a “lightning rod,” she added.

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